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RHEBAAA/DEPT OF ENERGY  
RUCNDT/USMISSION USUN NEW YORK 0808  
RUCPDO/DEPT OF COMMERCE  
RUEATRS/DEPT OF TREASURY  
RHEHNSC/NSC WASHDC

C O N F I D E N T I A L SECTION 01 OF 04 CARACAS 000666

SIPDIS

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ENERGY FOR CDAY, DPUMPHREY, AND ALOCKWOOD  
NSC FOR DTOMLINSON

E.O. 12958: DECL: 01/12/2017

TAGS: [EPET](#) [ENRG](#) [EINV](#) [ECON](#) [VE](#)

SUBJECT: SERVICE COMPANIES: THE NOOSE BEGINS TO TIGHTEN

REF: A. 2006 CARACAS 03402

[1](#)B. 2006 CARACAS 03559

[1](#)C. 2006 CARACAS 00905

[1](#)D. CARACAS 183

[1](#)E. 2005 CARACAS 2934

Classified By: Economic Counselor Andrew N. Bowen for Reason 1.4 (D)

[1](#)1. (C) SUMMARY: PDVSA is considering the formation of one or more service companies that will compete directly with the private sector. In addition to this threat, service companies still face payment delays and a myriad of administrative hurdles in dealing with PDVSA. As a result, private sector service companies are limiting their exposure in Venezuela or completely withdrawing from the market. We expect PDVSA's myopic policies to lead to further declines in production. END SUMMARY

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JUST WHEN YOU THOUGHT IT WAS SAFE....  
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[1](#)2. (C) Wood Group Vice President for South America Neil Harvie (strictly protect throughout) told Petroleum Attache (Petatt) on March 21 that he believes PDVSA will form one or more service companies within three to six months. Harvie was not sure if PDVSA planned to form a single direct subsidiary that would provide a variety of services or a series of joint ventures that focused on particular markets. He stated it was possible PDVSA could form a service company from small, expropriated local service companies. He added that he spoke recently with a young PDVSA employee who worked in the planning section. The employee implied that he was certain PDVSA would form a service company at some point in the future. When Harvie noted that would mean that international service companies would be competing against their only client for contracts, the PDVSA employee agreed.

[1](#)3. (C) As reported in Reftel A, PDVSA announced last October

that it expected service companies to form joint ventures in order to provide goods and services to PDVSA. Harvie stated Wood Group was told prior to the December presidential elections that it would be participating in two joint ventures. Wood Group was never given any specifics on the nature of its participation or the ownership structure of the joint ventures. Harvie stated the first joint venture was to provide training services to PDVSA personnel. Wood Group was not concerned about the joint venture because training programs require very little investment and it already had a program in place. Harvie stated Wood Group in conjunction with the University of Aberdeen is providing Lukoil employees with extra heavy crude oil training in case the Russian company decides to invest in the Faja.

14. (C) The second proposed joint venture was to build off-shore gas platforms. Unlike the training proposal, Wood Group was concerned about the joint venture since it involved an engineering team with specialized knowledge. Harvie stated that an Iranian was going to head the joint venture. According to Harvie, President Chavez was scheduled to unveil the joint venture projects in a public ceremony as part of his re-election campaign. For some reason, Chavez decided not to go ahead with the ceremony, and the projects withered on the vine.

15. (C) Harvie is not the only oil sector executive who believes that the BRV and PDVSA will radically reform their policies toward service companies. Visiting analysts from the Euarasia Group told Petatt on March 28 that they had heard a number of rumors that PDVSA was going to form a service company that would compete directly with the private

CARACAS 00000666 002 OF 004

sector.

16. (C) In addition, Juan Santana (strictly protect throughout), Program Manager for GX Technology (GX), a seismic company, told Petatt on March 27 that he is convinced PDVSA is going to form a service company to carry out seismic services. He stated PDVSA has purchased 10,000 channels of seismic hardware for the proposed company. (NOTE: We are not quite sure what Santana meant by this but it was clear from the context that he viewed it as a significant investment. END NOTE). Santana said PDVSA wanted to form a niche seismic company as the result of collusion on bids between seismic acquisition companies, including Chinese companies. As a result of mistreatment by PDVSA, the acquisition companies agreed to consult with each other before placing their bids. PDVSA gave the companies a stern lecture once it discovered they were colluding. Santana stated the companies only colluded on acquisition bids and not processing bids.

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STRAIGHT OUT OF KAFKA  
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17. (C) As reported in Reftel B and C, service companies have faced a myriad of administrative problems ranging from payment delays to administrative nightmares. Despite declining production, the BRV and PDVSA show no interest in improving the operating environment for service companies. Harvie noted, for example, that Wood Group's electric submersible pump unit has not been paid in a year. As noted in Reftel D, service companies appear to be limiting their exposure to Venezuela or completely withdrawing from the market. As near as we can tell, these trends appear to be on the upswing.

18. (C) GX's recent decision to pull out of the Venezuelan market is a prime illustration of the problems service companies face in Venezuela, the incentives they have for limiting their exposure, and the steep opportunity costs the BRV has and will pay for its myopic policies. Santana stated his company has formed a one year joint venture with its Venezuelan partner, Suelopetrol. Suelopetrol will take over

GX's processing operations and GX personnel will be withdrawn. Santana stated other seismic companies, including Grant Geophysical are leaving the Venezuelan market as well.

¶9. (C) According to Santana, his company entered Venezuelan market because of its vast potential. The company offered to create a data library for the BRV and PDVSA three years ago free of charge. Under the proposal, GX would shoot and process seismic data for the Venezuelan coast. It would then tie its results to similar projects in Guyana and Trinidad and Tobago, creating a complete seismic picture of 24,000 kilometers of off-shore territory. Underwriters, which included international and national oil companies, would pick up the cost of the project and have the opportunity to purchase the package at a steep discount. The BRV stated GX could only proceed with the project if it identified its underwriters as required by Venezuelan law. GX refused and the BRV eventually amended the law in question. However, it never gave approval for the project and GX eventually tired of waiting. Santana claimed that the BRV's inability to act has come back to haunt it in recent gas rounds. He blamed the lack of participation by private sector companies on the poor quality of PDVSA's data packages.

¶10. (C) To add insult to injury, PDVSA voided eight to nine seismic processing contracts in 2006 on questionable grounds. Santana lost several USD one million-plus contracts that it had won. It lost one of its contracts because it could not produce a labor certificate in time. When GX officials

CARACAS 00000666 003 OF 004

explained that it took over six months to get the certificate, PDVSA officials were unmoved. Santana stated as a result of PDVSA's administrative entanglements, little or no new seismic has been shot in Venezuela in the past three to four years. In 2006, only one company shot seismic and only one company processed data. GX is now focusing its attention on the ColombiaSpan project, a regional seismic program that will span the northern margin of South America with 3,500 kilometers of seismic data. He noted the Colombian government has enthusiastically supported the project.

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SIZE DOES NOT MATTER  
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¶11. (C) Major service companies face the same problems as their smaller competitors. A senior executive at a major service company told Petatt on May 29 that his company's costs have risen even faster than revenue increases. The problem is further exacerbated by PDVSA's practice of trying to pay in bolivars rather than dollars. As a result, the company has taken a variety of cost cutting measures, such as reducing travel. In addition, PDVSA does not execute contracts in a timely manner. Although the company has bent over backwards trying to help PDVSA, it has begun to pull resources out of Venezuela due to a lack of contracts.

¶12. (C) PDVSA further complicates life for the major service companies by refusing to let them place staff in PDVSA offices and facilities on a permanent basis. The executive stated it was common practice for his company to embed personnel in client's offices in order for them to act as a team with the client's personnel. PDVSA also does not permit service companies to send data outside of the country. As a result, a proposal by the company that required the transmission of data to a satellite was rejected in part because the data would leave Venezuela.

¶13. (C) The executive also stated PDVSA's obsession with control was costing it dearly in terms of production. For example, production at the Dacion field, which the BRV expropriated from ENI, has declined dramatically. The executive stated production continues to decline and is approaching the 50% mark. The production decline stems in part from PDVSA personnel's inability to properly dispose of

water and the poor maintenance of electric submergible pumps.

In addition, there is not enough gas for pressure maintenance.

¶14. (C) The executive complained bitterly that his company has tried to assist PDVSA but is treated with suspicion. On the other hand, PDVSA is full of consultants who frequently do not have the necessary technical expertise to carry out projects. To add insult to injury, the consultants are paid in dollars, rather than bolivars.

¶15. (C) The executive stated at one point his company presented PDVSA with an integrated project management proposal that was designed to address many of PDVSA's weaknesses, particularly its lack of trained personnel. Under the proposal, the service company would have taken over the entire well drilling process and presented PDVSA with "turnkey" wells. The company was even willing to let PDVSA assign personnel to the individual projects so that they could receive on the job training. The executive noted that many of PDVSA's drilling supervisors have very little experience, in some cases, as little as three months. PDVSA rejected the proposal out of hand on the grounds that it had to maintain absolute control.

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CARACAS 00000666 004 OF 004

COMMENT

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¶16. (C) As noted in Reftels A and D, it is not clear if senior BRV and PDVSA officials are aware of the price they will have to pay for alienating the service companies. It is also not clear if their actions are the result of malevolence, incompetence, corruption or a combination of all three. Close personal relationships do not appear to matter.

Santana was clearly mystified by the actions of the BRV and PDVSA officials. He claimed to have a close personal relationships with several BRV and PDVSA officials and has done special projects for the Energy Ministry. He said senior officials frequently approached him at social gatherings and in the hallways of the Energy Ministry to assure him that his deals were moving forward. His claims of a close personal relationship ring true to us. When Santana and Petatt's flight arrived late at Maquitia airport, a BRV immigration official met Santana and escorted him through the diplomatic line. Santana is not the only service company executive with close personal relations with senior BRV officials who has failed to close deals. Dr. Hugo Hernandez, a former PDVSA board member who appears to have a close relation with senior BRV officials (Reftel E), has also complained to Petatt in the past that he cannot secure approval for his proposals to reopen mature fields in Zulia.

¶17. (C) The question at this point is how far service companies will go in limiting their exposure to Venezuela. It is hard to imagine Venezuela stabilizing production, let alone increasing it, if it does not have the support of the service companies. A partner at the law firm of Squire Sanders told Petatt on March 28 that a Citgo vice president told him that the BRV's current oil policies were unsustainable and that significant changes would have to occur within the next three years. The Citgo official also claimed that PDVSA's production costs had skyrocketed to USD 30 per barrel.

BROWNFIELD